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VIA FEDERAL EXPRESS

Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

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DEC 19 1996

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Re: In the Matter of Federal-State Joint Board on Universal Service Comments of the
Minnesota Independent Coalition on Recommended Decision
Docket No.: 96-45

Dear Secretary:

Enclosed for filing are an original and four (4) copies of the Comments of the Minnesota Independent Coalition on the Universal Service Recommended Decision. Also enclosed is our affidavit of service.

If you should have any questions regarding the enclosures or other issues with respect to the filing submitted on behalf of the Minnesota Independent Coalition please feel free to contact the undersigned.

Very truly yours,

MOSS & BARNETT,
A Professional Association


Richard J. Johnson

Enclosure

cc: All parties of record (with enclosure)

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

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DEC 19 1996

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In the Matter of
Federal-State Joint Board on
Universal Service

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CC Docket No. 96-45

**COMMENTS OF THE MINNESOTA
INDEPENDENT COALITION**

The following Comments are submitted by the Minnesota Independent Coalition in response to the Public Notice, released November 18, 1996. The Minnesota Independent Coalition is an unincorporated association of over 80 small Rural Telephone Companies, within the meaning of 47 U.S.C. § 153(47), providing telephone exchange service and exchange access service in Minnesota. Although the average size of these Companies is under 3,000 access lines, collectively the members of the Minnesota Independent Coalition provide telephone exchange and exchange access service to over 200,000 access lines in Minnesota.

These comments will address some of the topics identified in the Public Notice and some of the specific recommendations contained in the Recommended Decision released November 8, 1996 by the Federal-State Joint Board (the "Recommended Decision"). These Comments will address issues of particular significance to the Minnesota Independent Coalition.

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SUMMARY OF COMMENTS
OF
MINNESOTA INDEPENDENT COALITION

DEC 19 1996

RECEIVED

The Minnesota Independent Coalition is pleased to respond to the request for comments made by the Common Carrier Bureau on November 18, 1996.

The Act gives universal service clear priority over competition in Rural LEC areas. The Recommended Decision (§§ 22 and 23) adopts "competitive neutrality" as an additional principle with priority equal to the six principles enumerated in 47 U.S.C. § 253(h). Application of that principle as an equal priority in Rural Telephone Company ("Rural LEC") services areas would directly conflict with Congress' determination that universal service take precedence over promotion of competition in Rural LEC areas. The determination is reflected in the express authority given in Section 253(f) to State commissions to limit universal service fund ("USF") eligibility to a single eligible telecommunications carrier ("ETC") and to States to condition competition in Rural LEC areas by requiring service to the entire Rural LEC area.

CLECs should be required to provide equal access if equal access is now provided in an area. The recommendation of a blanket waiver of equal access as a required service obligation (§ 66) should not be adopted. In those areas where the incumbent LEC offers equal access, a CLEC should also be required to offer comparable equal access because the failure to do so would lower the quality of service to end users and would give combined CLEC/interexchange carriers an unfair advantage. Neither of these results should be funded by the federal universal support mechanisms.

Support levels should reflect local factors that affect both the cost and the affordability of qualifying services. The Recommended Decision properly recognizes the need to consider local variations in calling scope, income level and cost of living in establishing an “affordable rate.” ¶¶ 128, 129 and 131. The proposals to freeze current support levels, including DEM weighting, long term support and high-cost support for three years (¶¶ 289, 290, and 291) and transition to a proxy cost model (¶¶ 270 and 290) should not be adopted because they fail to reflect those variations and would violate the requirements that rates be “affordable” and that rural rates be “reasonably comparable” to urban rates.

Use of forward looking costs will cause Rural LECs to under-recover the actual cost of service and violate the requirement of “sufficient” support. The recommendation to transition to the use of a proxy cost model based on forward looking costs (¶¶ 184, 264, 275, and 277) should not be adopted. The investments made by Rural LECs do not occur in a smooth pattern because of the limited size of Rural LECs’ service areas. As a result, the actual investment costs of Rural LECs can achieve the level of theoretical, most efficient forward looking costs. The result will be under-recovery of the Rural LECs actual costs which determine the rates paid by customers. That under-recovery, in turn, would result either in a decision to avoid future investments or in increased rates. Either result violates the requirement that universal service support be “predictable” and “sufficient” to achieve rates that are “affordable” and “reasonably comparable” between rural and urban areas.

USF support should not be limited to single lines in primary residences or to single-line businesses. The recommendation to limit support to single lines in primary

residences and businesses (§ 90 and 91) should not be adopted. While the Act allows special consideration for the needs of low-income consumers, the Act also requires reasonable comparability for rural areas. In addition, the proposed limitations would be impossible to enforce and would violate the requirements that support be “predictable”.

Competitive bidding is inappropriate for Rural LEC service areas, and does not merit further study. The recommendation to further study competitive bidding for Rural LEC service areas (§ 349) should not be accepted. Competitive bidding is intended to be used where there are multiple competing carriers seeking USF support, and it is unlikely that Rural LEC service areas will have multiple service providers. Further, bidding is designed primarily to reduce the level of support provided, which is inconsistent with the requirement of “sufficient”. Bidding also violates the requirement that funding be “predictable,” since it could change as the results of competitors’ bids.

Existing special prices given to qualified schools and libraries should be eligible for USF support. The recommendation that existing special prices and arrangements to schools qualify for support (§ § 571 and 572) should be adopted. Existing programs should qualify upon demonstrating that the prices received are below the “lowest corresponding price.” See § 540.

USF Support to a CLEC in a Rural LEC area should be based on the CLEC’s costs and should not include funding for resold services. The recommendation that CLECs receive the same USF payment per access line paid to a Rural LEC (§ § 296 and 297) should be rejected. This would result in uneconomic subsidies to the CLECs and unfair competition. CLECs should qualify for USF support based on their actual costs. In addition,

USF support should not be provided to a CLEC for a resold service because it would provide the CLEC with an unfair economic advantage and violate the pricing principles of the Act.

USF contributions should be based on gross retail revenues. The proposal to collect the USF contribution based on gross revenues less amounts paid to other carriers (§§ 12 and 807) should be rejected. This proposal would provide non-facilities based competitors with an unfair advantage and violate the requirement that the contribution be “nondiscriminatory”. Total retail revenues provide a competitively neutral base.

The required service areas for carriers serving Rural LEC areas should be the existing study areas. The recommendation to adopt the existing study areas as the required service areas for Rural LEC areas (§§ 134, 172 and 174) should be adopted. This requirement will prevent universal service funding of CLECs serving only more profitable areas of a Rural LEC, thereby preventing universal service funding of unfair competition.

The appropriate treatment of the CCL charge should be resolved in the access proceeding. The recommendation to study the appropriate role of the CCL charge in the Commission’s Access Charge Investigation (§ 774) should be adopted.

NECA should be selected as the permanent administrator of the USF program upon demonstrating its neutrality. After NECA completes its proposed changes to its advisory board, it should be appointed the administrator of the USF.

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I. THE PRINCIPLES IDENTIFIED IN SECTION 254(b) TAKE PRIORITY OVER COMPETITIVE NEUTRALITY IN THE CONTEXT OF RURAL AREAS.

Congress has established priorities concerning universal service that the Commission may not change by the adopting of additional principles. The priority that universal service goals not be impaired to promote competition in rural areas is apparent in several provisions of the Act. The adoption and application of the principle of competitive neutrality in rural areas is inconsistent with the priorities of the Act in several respects.

A. The Recommended Decision Intends to Apply Competitive Neutrality As An Equal Priority Principle In All Areas.

The Recommended Decision proposes that “competitive neutrality” be included as an additional principle to be given equal weight with the principles set forth in Section 254(b). The Recommended Decision reads in part:

“Policy on universal service should be a **fair and reasonable balance of all of those principles identified in Section 254(b) and the additional principle** we identify in this Section. We recognize, however, that our primary responsibility on this matter is to ensure that consumers throughout the nation are not harmed and are benefited under our recommendation. . . .

At ¶ 22. (Emphasis added.)

The Recommended Decision also intends this principle to be applied with equal priority in all areas, saying in part:

We recommend that the Commission also establish “competitive neutrality” as an additional principle upon which it shall base policies for the preservation and advancement of universal service, pursuant to Section 254(b)(7) . . . we further believe that the principle of competitive neutrality should be implied **to each and every recipient and contributor to the universal service support mechanisms, regardless of size, status or geographic location.** . . .

At ¶ 23. (Emphasis added.)

The Recommended Decision frequently applies this principle in discussion of additional issues.

B. Any Additional Principles Adopted By the Commission Must Be Consistent With the Priorities Of the Act.

The need for consistency with the Act certainly requires that any additional principles adopted by the Commission and Joint Board must conform to the priorities that Congress has established in the Act. Section 254(b)(7) expressly limits the addition of further principles to consistency with the Act, saying in part:

Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and **are consistent with this Act.**

(Emphasis added.)

With such a clear expression of Congressional intent, the additional principle of competitive neutrality must remain subordinate to the specific goals identified in the Act and must not be allowed to impair the Congressional priority of universal service in the areas served by rural telephone companies.

C. Congress Chose Not to Adopt a Broad Policy of Competitive Neutrality With Respect to Universal Service.

In addition, it is clear that Congress chose not to set forth a broad principle of “competitive neutrality” in the context of universal service. Instead, the Act articulates the principle of neutrality only with respect to **contributions** to the universal service fund. Section 254(b)(4) reflects the principle that:

All providers of telecommunications services should make an equitable and non-discriminatory contribution to the preservation and advancement of universal service.

The presence of such an explicit and narrowly applied principle of “non-discrimination” indicates that Congress had drawn a specific balance with the other express principles, which must not be altered by the rules promulgated by the Commission. Certainly, there would be no justification to ignore the clear preferences and priorities reflected in the Act for universal service in Rural LEC areas for which Congress specifically contemplated that only a single recipient of funding may be named.

D. Application of Competitive Neutrality As a Principle Of Equal Priority In Rural Areas Violates the Act.

Application of the principle of competitive neutrality to rural areas would expressly conflict with the specific limitations that Congress imposed on the designation of additional eligible communications carriers. Section 214 of the Act expressly allows State commissions to limit USF eligibility to a single Rural Telephone Company, and Subdivision 214(e)(2) goes on to require:

Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission **shall** find that the designation is in the public interest.

(Emphasis added.)

Section 253 generally bars states from erecting barriers to the entry of new LEC competitors, but the Act specifically allows states to limit the entry of competitors in rural telephone areas to those that will install facilities and provide service throughout the Rural LEC’s study area. Subsection 253(f) provides:

It shall **not** be a violation of this section [253] for a State to require a telecommunications carrier that seeks to provide telephone exchange service or exchange access in a service area served by a rural telephone company to meet the requirements in section 214(e)(1) of this title for designation as an **eligible telecommunications carrier** for that area **before being permitted to provide such service**.

(Emphasis added.)

E. Conclusion.

The Joint Board's proposal to add "competitive neutrality" to the principles enumerated in Section 253(h) ignores Congress' clear preference for universal service in Rural LECs (particularly where, in the absence of competitors willing to provide facilities and region wide service, there is only one eligible recipient of USF support). Contrary to Section 253(b)'s consistency requirement, broad application of a competitive neutrality principle to areas served by Rural LECs would conflict with the Act. The Board's recommendation should, therefore, be rejected by the Commission.

II. EQUAL ACCESS SHOULD BE INCLUDED IN THE DEFINITION OF UNIVERSAL SERVICE FOR AREAS WHERE IT IS ALREADY PROVIDED.

While it may be appropriate to not require equal access in areas where it has not been already provided, it would be inappropriate and inconsistent with the rationale of the Recommended Decision to exclude equal access from universal services in all circumstances. There is no basis to provide federal funding to competing ETC's who will provide a service that will diminish the service now provided or where the competing ETC's do not face any technological obstacle to providing equal access.

A. Elimination of Equal Access For All CLECs Is Inconsistent With The Narrow Exemptions Recommended For Other Services.

The Recommended Decision proposes to include access to interexchange service within the definition of Universal Service, but does not propose including the obligation to provide equal access. ¶¶ 65 and 66. The Recommended Decisions states in part:

We acknowledge the importance of equal access . . . but we conclude that equal access should not be supported because of the **potential costs to wireless carriers** involved in upgrading facilities and because wireless carriers are not currently required to provide equal access.

At ¶ 66 (emphasis added).

The Recommended Decision correctly concludes that all the universal services must be provided, absent exceptional circumstances:

We recommend that telecommunications carriers that are unable to provide one or more of these services should not receive universal service support unless exceptional circumstances exist. We conclude that conditioning a carrier's eligibility for support upon its provision of the core services will not impose an anti-competitive barrier to entry At ¶ 79.

Waivers should not generally be available. ¶ 83. GTE's request for a general transition to single party service was rejected. ¶ 81. Instead, the Joint Board proposed that State commissions be allowed grant specific carrier requests for transition to single party service. ¶ 81. The grant of such requests was limited:

Such a request will be granted only if the state commission finds exceptional circumstances warrant an exemption from this requirement.

The broad exclusion of equal access from the definition of universal services, based on the needs of CMRS providers, is inconsistent with these standards.

B. Elimination Of Equal Access For All CLECs Is Inconsistent With the Principles That Commission Must Consider Under the Act.

While the Act directs the Commission to define the services that are supported by Federal funding, the Act also provides the basic criteria that the Commission must consider.

Section 254(c)(1) reads in part:

The Joint Board in recommending, and the Commission in establishing, the definition of the services that are supported by Federal universal service support mechanisms shall consider the extent to which such telecommunication services --

...

(B) have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers;

(C) are being deployed in public telecommunications networks by telecommunications carriers; and

(D) are consistent with the public interest, convenience, and necessity.”

Equal access meets each of these criteria. Equal access is available to a vast majority of residential customers, who have exercised the opportunity to presubscribe to “1+” carriers for interstate, interLATA and, in many cases, intraLATA service. The deployment of these features throughout public telecommunications networks is the norm. In general, equal access has not been provided only where there has been no request for installation. Equal access has been consistently found by the Commission and State commissions to be in the public interest, convenience and necessity.

The Act supports requiring equal access as a basic service component at least where it is now available. Section 251(g) requires all ILECs to maintain existing equal access offerings, and Section 271(e)(2) makes intraLATA equal access a precondition to a Bell Operating Company offering interLATA services. Clearly, equal access is in the public interest, and any universal service funding exemptions for CLECs from providing equal access in service areas where the incumbent LEC provides equal access should be narrowly drawn and limited in duration.

C. Elimination of Equal Access From Universal Service Is Not Supported By Section 332(c)(8).

Section 332(c)(8) grants CMRS providers an exemption from the obligation to provide equal access to common carriers for the provision of telephone toll services, but a similar

exemption was denied to LECs. Rather, Section 251(g) requires that equal access be maintained as now provided. The concession granted to CMRS providers from the obligation to provide equal access does not justify Joint Board's recommendation to allow funding of CLECs who may merely choose not to provide equal access without any technological basis and who will be competing with LECs that are required to provide the service. By refusing to offer equal access, a combination CLEC/IXC can enhance its earnings by bundling its local and interexchange services. Clearly, universal service funding of such a decision by a CLEC would confer an unfair competitive advantage not justified by technological limitations or other sound policy reason.

Providing an equal access exemption to CLECs, such as AT&T and MCI, would allow them to receive universal service funding while severely impairing the level of services now provided to the majority of residential customers who have access to "1+" prescription. Such an accommodation would significantly degrade the quality of services eligible for USF funding.

Nor does the CMRS equal access exemption set forth in Section 332(c)(8) resolve the separate issue of whether CMRS providers should be eligible for USF support. The policy underlying the first accommodation to CMRS providers (exemption from the obligation to provide equal access) does not justify an additional accommodation (eligibility for USF funding).

D. Universal Service Should Not Be Eliminated for CLECs if it is Currently Provided in an Area.

Instead of creating a blanket exclusion of equal access, any exemption should follow the prevalent rationale of the Recommended Decision and limit the exemption to a demonstration of "exceptional circumstances," particularly for CLECs that are not limited by CMRS switching characteristics. ¶ 79. To the extent that such exemptions are provided, they should be granted on

a case-by-case basis by State commissions. The Board acknowledged the States commission's role in addressing limited exceptions to the general USF service obligations when it recommended, "that states have the discretion to provide for a transition period, for good cause, to allow carriers to make to make upgrades to provide single-party service." (Recommended Decision, ¶ 79.) The State commissions are better positioned to appropriately evaluate and limit the scope and duration of any universal service exemption to their individual circumstances.

Allowing State commissions to resolve requests for exemption is also consistent with Section 254(f) of the Act, which reserves to the States the authority "to preserve and advance universal service," so long as the State regulations are consistent with the Commission's rules and provide appropriate funding.

The State commissions are in the best position to evaluate whether and under what circumstances CLECs and CMRS providers should be eligible to receive universal service funding without the obligation to provide equal access. A blanket exemption from a service that is both the norm and has been found to be in the public interest should not be granted by the Commission.

III. SUPPORT LEVELS TO UNIVERSAL SERVICE PROVIDERS SHOULD DIRECTLY REFLECT FACTORS THAT AFFECT AFFORDABILITY FOR CUSTOMERS.

The Act establishes specific, new criteria for universal service. Section 254(b)(1) requires that "[q]uality services should be available at just, reasonable, and **affordable** rates." Section 254(b)(2) requires that:

[c]onsumers in all regions of the nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, **that are reasonably**

comparable to those services provided in urban areas and that are available at **rates that are reasonably comparable** to rates charged for similar services in urban areas.

(Emphasis added.) Both “affordability” and “reasonable comparability” are the result of rates charged to customers. It is obvious, however, that the level of USF support provided will determine whether it is feasible for Rural LECs to provide services at rates that are “affordable” and “reasonably comparable” to the rates charged in urban areas.

The Joint Board recognizes that local variations in calling scope, income level and cost of living can affect affordability; but the Board recommends freezing per line support levels for Rural LECs at their current levels for 3 years, with a 3 year transition to proxy rates to follow. If support levels to Rural LECs are based on these recommendations, the statutory obligation to provide universal service at rates that are affordable and comparable to those charged in urban areas may not be met in many Rural LEC service areas.

A. The Joint Board Recognizes The Effect of Local Variations In Calling Scope, Individual Income And Cost Of Living On Affordability.

The Recommended Decision correctly recognizes that a variety of factors, including local calling scope, income levels and cost of living, all impact “affordability” within the meaning of the Act. ¶¶ 126, 128, 129 and 130. The scope of local calling areas directly affects not only “affordability” but also “reasonable comparability” of rates and services between large calling areas (urban areas) and small calling areas (rural areas). See Section 254(b)(2), *supra*.

1. Local Calling Scope Affects Affordability.

Local calling scope clearly affects both the affordability of the services and the comparability of the services. As the Recommended Decision notes:

[I]dentical rates may not be equally affordable when the extent of their associated local calling areas differ.

At ¶ 128.

The Joint Board recognizes that there may be wide variations between services having the same description. For instance, the Minneapolis/St. Paul Metropolitan Area has one of the largest toll free calling areas in the nation, providing flat-rate calling availability to almost 1,500,000 local lines. For many Rural LECs, including most Minnesota Independent Coalition members, toll free access is provided to less than 1,500 access lines, with many exchanges having fewer than 500 other access lines available in the local calling area. From the perspective of the customers, the local services provided in the Minneapolis/St. Paul Metro area and in rural exchanges are hardly “comparable”, because the Metro Area service includes toll free calling to 1,000 to 3,000 lines for each 1 line available in the rural exchanges.

Customers in the Metro Area actually call far fewer than the 1,500,000 lines available. They use some combination of local and interexchange services to meet their actual community of interest calling needs. Customers in small exchanges also use some combination of local and interexchange services to meet those needs. However, the use of interexchange services will be significantly higher for customers in small exchanges to meet their calling needs. Consequently, the total monthly charges for interexchange services in small exchanges are likely to be higher, thereby reducing the affordable level for local service.

The prices paid for extensions of local calling scope, such as Extended Area Service (“EAS”), should also be taken into consideration. Many exchanges served by Rural LECs in Minnesota have EAS into the Minneapolis/St. Paul metro area, with monthly charges for that EAS of over \$50 per month. Conversely, US WEST customers located in the metro area pay no EAS surcharge. Clearly, EAS charges also affect the affordability of local telephone service.

2. Local Income Levels Affect Affordability.

The Recommended Decision also properly recognizes that national income averages are insufficient to guide determinations of whether telephone service is affordable in a specific location. The Recommended Decision reads in part:

[W]e conclude that per capita income of a local or regional area, not a national median, should be considered in determining affordability.

At ¶ 129. The national median level of income would, by definition, tend to overestimate the price at which service is affordable when applied to a service area having an income that is significantly below the national median. In recognition of this fact, the Joint Board correctly recommends using area specific income data.

3. The Joint Board Correctly Found That A Nationwide Determination Of An Affordable Rate Would Not Accomplish the Goals Of The Act.

The same logic is reflected in the Joint Board's recommendation that it is **not** appropriate to establish a nationwide "affordable rate." The Recommended Decision reads in part:

In finding that States should assume primary responsibility in insuring affordability, we expressly reject the approach favored by some commentators that the Commission designate a nationwide affordable rate.

At ¶ 131. These recommendations correctly recognize the need to reflect the impact of local characteristics in determining of an affordable rate for a particular LEC and its customers.

B. The Joint Board's Recommendations For Setting Support Levels Fail To Reflect The Effect Of Local Variations On Affordability.

While the Joint Board has properly recognized the need to reflect individual characteristics in the determination of affordability, the joint Board's recommendation for determining support levels is completely at odds with this recognition. Rather, support levels are

set without regard to individual characteristics of calling scopes, income levels, or operating expenses and current investments needed to maintain quality services.

Specifically, the Recommended Decision would freeze support levels for Rural LECs at current levels on a per line basis. ¶ 290. High cost support would be based upon support received in calendar year 1997. ¶ 289. This, in turn, is based upon 1995 embedded costs. ¶ 291. DEM and LTS support would be based upon the support received in calendar 1996. ¶ 289.

Freezing support levels for Rural LECs for the next 3 years based on this historic data without consideration of calling scopes, income levels or current costs will not properly reflect the current circumstances of many Rural LECs and their customers and the need for new investments to meet the Act's requirement for modern, quality services.

The Joint Board proposes the use of proxy cost models that simulate local conditions; but for LECs using a proxy cost model (including Rural LECs after their recommended 6 year transition to proxies), the Board would set the USF support level at an amount equal to the difference between the proxy cost and a **nationwide average of revenue per line** (including access and all local services). ¶ 311. Using national average revenue to determine USF support levels will necessarily fail to reflect the impact of calling scopes and individual incomes on customer purchases of telecommunications services for many Rural LECs. If access charges are significantly reduced, the historical offsetting effect of access revenues will also be eliminated.

These recommendations for setting support levels for Rural LECs fail to reflect the Board's own explicit recognition that local variations in calling scope, income levels and cost of living must be considered. The result may well be a failure to accomplish the mandate of the Act that rates must be "affordable" and "reasonably comparable" between rural and urban areas.

C. The Determination Of USF Support Levels For Rural LECs Can And Should Directly Reflect Local Factors That Affect Affordability.

Affordability must be directly included in determining support levels for Rural LECs.

The support levels provided to Rural LECs will determine the rates paid by the Rural LEC's customers, which is the true measure of the success of setting support levels to achieve affordable rates. Such a determination could be made as follows:

$$\begin{array}{rcl} & \text{Costs (embedded, including reasonable return)} & \\ \text{less} & \text{Access Revenues (after Access Reform)} & \\ \text{less} & \text{Target "Affordable" Local Rates to be Paid by Customers [Reflecting Calling} & \\ & \text{Scope [Including EAS Paid and Toll Usage], Income Levels, Cost of Living]} & \\ = & \text{Support Needed From Federal Mechanisms} & \end{array}$$

One way to reflect the impact of differences in calling scope of various customer groups is to compare the average total monthly bills for the groups. Appropriate data to conduct such a comparison is contained in the Subscriber Information section, Lines 60 - 249, of the USF Data Collection conducted in 1995. State commissions are well suited to determine which of the services are needed to communicate within the groups' various communities of interest in each State. While such determinations would require substantial effort by the State commissions, such effort is justified given the importance of the Congressional goals of affordability and comparability between rural and urban customer groups.

Because most customers in rural areas need to use far more short haul interexchange service than customers in large urban areas, to achieve the goals of affordability and comparability, it will be necessary that:

1. the rates for flat rate local service in rural areas be significantly lower than the flat rates for local service in urban areas; and

2. there must be sufficient support to the appropriate LECs to allow such lower local rates to be maintained.

There may be other methods of determining support payments that appropriately reflect the requirement that services supported by USF be “affordable”, but the Joint Board’s recommendations fail to do so both for the Rural LECs and other LECs.

D. Conclusion.

For the reasons set forth above, the Commission should:

1. Accept the Board’s findings on the effect of local variations in calling scope and income on affordability; and
2. Act on that recognition by including these factors in the methodology for determining USF support levels.

IV. THE REQUIREMENTS OF THE ACT DO NOT ALLOW MANDATORY USE OF FORWARD -LOOKING PROXY COSTS FOR RURAL LECs.

The Recommended Decision reflects several recommendations to limit universal support that are inconsistent with the requirements of the Act, which arise from a focus on economic efficiency and cost reductions. These recommendations should not be adopted by the Commission.

A. Requiring Use Of Proxy Cost Models By Rural LECs Will Violate The Act.

The Recommended Decision appears to recognize the defects of proxy models for Rural LECs, yet assumes that appropriate proxy models will be available after three years. The Recommended Decision reads in part:

While we recommend the use of proxy models in general, we recognize that the operations of some carriers could be placed at risk if their support was immediately determined by the use of a proxy model. As suggested by various

commentators, the proposed proxy models' designs do not reflect the special characteristics of these carriers. First, none of the models adequately represents the costs for rural carriers and all the models are currently based on expense data for large LECs serving predominately urban areas. Second, small carriers, with their limited revenue streams, will be significantly affected if the model does not accurately reflect their costs. Third, the proxy model should be refined and modified to reflect the special characteristics of rural carriers before requiring those carriers to move to a proxy model for determining universal service support.

At ¶ 271.

The Recommended Decision recognizes that some carriers “could be placed at risk” and that carriers with “limited revenue streams, will be significantly affected if the model does not accurately reflect their costs.” This recognition poses the question: What revenue streams are needed to avoid “risk” and significant adverse impact on customers? Clearly, the necessary revenue streams are those required to pay the embedded costs of operation. If a model does not accurately reflect those embedded costs, the USF support will not be adequate to support the costs of operation of Rural LECs, causing rates to increase and the failure to accomplish the goals of the Act.

Only a cost model based on recovery of Rural LEC's actual, ongoing embedded costs assures achievement of the requirement of the Act that rates remain affordable for customers. Embedded costs are those incurred by real companies to serve real customers using technology that was most efficient when installed and was required by regulatory authority to fulfill universal service obligations. To consider costs inefficient because a better alternative now exists and to penalize carriers for fulfilling service obligations is contrary to both logic and the achievement of “affordable” rates and quality service.